Supreme Court, U.S.
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No. OFFICE OF THE CLERK

In The

Supreme Court of the United States

October Term, 1993

MED-THERAPY REHABILITATION SERVICES, INC., NS&H, INC. and BRIAN CENTER MANAGEMENT CORPORATION,

Petitioners,

v.

DIVERSICARE CORPORATION OF AMERICA,

Respondent.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED FOR REVIEW

Where it is established that a person fraudulently procured a sale of securities, does a district court, in fashioning relief for the defrauded buyer in an action under Rule 10b-5, have the power under Section 29(b) of the Securities Exchange Act of 1934 to void the violating party's rights under the contract if that party has performed the contract?

PARTIES TO THE PROCEEDINGS BELOW

The parties to the proceedings before the Court of Appeals for the Fourth Circuit appear in the caption of this Petition. Pursuant to Rule 29.1, the only additional company that is a parent company or subsidiary (except wholly-owned subsidiaries) of Petitioners is The Brian Center Corporation, which is the parent of Petitioners Med-Therapy Rehabilitation Services, Inc. and Brian Center Management Corporation.

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MED-THERAPY REHABILITATION SERVICES, INC., NS&H, INC. and BRIAN CENTER MANAGEMENT CORPORATION,

Petitioners,

v.

DIVERSICARE CORPORATION OF AMERICA,

Respondent.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit

PETITION FOR WRIT OF CERTIORARI

Petitioners, Med-Therapy Rehabilitation Services, Inc., NS&H, Inc. and Brian Center Management Corporation, respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Fourth Circuit entered in these proceedings on February 3, 1994.

OPINIONS BELOW

The opinion of the Court of Appeals for the Fourth Circuit is unreported and is reprinted in the appendix at App. 1-16.

The opinion of the United States District Court for the Western District of North Carolina (by the Honorable Richard L. Williams of the United States District Court for the Eastern District of Virginia, sitting by designation) is unreported and is reprinted in the appendix at App. 17-35.

JURISDICTION

Petitioner invokes the jurisdiction of this Court under 28 U.S.C. § 1254(1). The Petition is timely under Rule 13 of this Court, as it is filed within ninety days after the Court of Appeals' denial of Diversicare's Petition for Rehearing on March 4, 1994.

STATUTE INVOLVED

The case involves the interpretation of Section 29(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78cc(b), which provides in pertinent part[1] as follows:

> Every contract made in violation of any provisions of this title or of any rule or regulation

[1] The full text of 15 U.S.C. § 78cc is set forth in the appendix hereto at App. 42-43.

> thereunder, shall be void . . . as regards the rights of any person who, in violation of any such provision, rule or regulation, shall have made or engaged in the performance of any such contract.

STATEMENT OF THE CASE

This case arises out of Med-Therapy's purchase from Diversicare, in April of 1988, of 100 percent of the stock of a company then known as National Speech and Hearing, Inc. ("National"). National was in the business of providing speech and hearing therapy services and it was a provider under the Medicare program. As consideration for its purchase of the National stock, Med-Therapy paid $750,000 in cash at closing and gave Diversicare a note having a face value of $700,000.[2]

Within months after Med-Therapy purchased National from Diversicare, the United States Government made substantial (in excess of $1 million) claims against National as a result of deficiencies in cost reports that National had filed with the Medicare program before the closing.[3] At no time during the negotiations relating to

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[2] The note was executed by National and was guaranteed by Petitioners Med-Therapy and Brian Center Management Corporation.

[3] The Medicare program is administered by "fiscal intermediaries," usually health and accident insurance companies, which make interim payments to providers based on providers' projected costs. At the conclusion of each fiscal year, providers file cost reports, which the fiscal intermediaries have the right to audit. A determination that a provider's actual costs were less

the sale of National did Diversicare disclose the possibility of overpayment claims of this magnitude; indeed, Diversicare represented in the Stock Purchase Agreement covering the sale that National's cost reports "complied in all material respects with applicable Medicare regulations." Unbeknownst to Med-Therapy prior to its purchase of National, National's fiscal intermediary was in the process of auditing National's cost reports during the several months leading up to the sale and at the "exit conferences" for these audits had announced significant adjustments to the cost reports. Officers of Diversicare were present at these exit conferences and were given extensive documentation outlining the auditors' adjustments. Two of the exit conferences occurred within weeks of Med-Therapy's purchase of National. None of this material information about National's liabilities was disclosed by Diversicare to Med-Therapy before closing.

Med-Therapy filed an action with the District Court, asserting claims, *inter alia*, for violations of Rule 10b-5 and common law fraud. Jurisdiction of the District Court was invoked under 28 U.S.C. § 1331. In its complaint, Med-Therapy specifically requested, as one of the remedies to which it was entitled because of Diversicare's violations of Rule 10b-5, that the District Court "enter a declaratory judgment pursuant to 28 U.S.C. § 2201 canceling the Note [*i.e.*, the $700,000 note given to Diversicare

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than the interim payments received by the provider during the year gives rise to an overpayment claim against the provider and the provider is obligated to return the excess to the fiscal intermediary. *See* 42 U.S.C. §§ 1395g, 1395u, 1395x(v), 1395mm(a).

in connection with the sale of National] and declaring that Diversicare has no rights thereunder."

The case was tried to a jury in October 1992. At trial, the District Court ruled that it would determine Med-Therapy's request that the note be canceled, following the jury's verdict. The jury returned a verdict in favor of Med-Therapy on its federal securities and common law fraud claims, awarding $300,000 and $252,527 on those claims respectively. The jury also awarded Med-Therapy $1,000 in punitive damages. The jury found in favor of Diversicare on a counterclaim for the balance allegedly due under the note and awarded Diversicare damages of $552,527.

In post-trial motions, consistent with the request for a declaratory judgment in its complaint, Med-Therapy requested that the District Court cancel the note and enter judgment in its favor on Diversicare's claim under the note, given the jury's finding that Diversicare had procured the note by fraud and given the express mandate of Section 29(b) of the Exchange Act that contracts made in violation of the Exchange Act "shall be void." The District Court granted the request, relying on Section 29(b) and case law thereunder, including *Sundstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033 (7th Cir.), *cert. denied sub nom. Meers v. Sundstrand Corp.*, 434 U.S. 874 (1977), and *Prudential-Bache Securities, Inc. v. Cullather*, 678 F. Supp. 601 (E.D. Va. 1987). App. 23.

The Court of Appeals reversed the District Court's cancellation of the note. The Court of Appeals disagreed with the District Court's interpretation of § 29(b), stating that "the courts have interpreted the provision [the 'shall

be void' language of § 29(b)] more loosely" than the meaning of its express terms, and that the District Court did not have the power to cancel the note. App. 9. The Court of Appeals also expressed the view that election of remedies principles barred Med-Therapy from invoking § 29(b) because Med-Therapy had sued for damages. App. 8-10. Thus, the Court of Appeals allowed Diversicare to recover $552,527 allegedly due under the note, despite the fact that Diversicare had fraudulently procured the note and despite the express provisions of § 29(b) voiding Diversicare's rights thereunder.

Diversicare filed a Petition for Rehearing, which was denied by an Order entered by the Court of Appeals on March 4, 1994. App. 40-41.

REASONS FOR GRANTING THE WRIT

1. This Court Should Resolve the Conflict in the Lower Courts Concerning the Proper Interpretation of the Voidness Provision of Section 29(b) of the Exchange Act.

There is substantial uncertainty in the courts of appeals and the district courts concerning the proper application of the language of § 29(b) of the Exchange Act stating that contracts made in violation of the Act "shall be void" as regards the rights of the violating party. In particular, the courts have come to varying results concerning the rights of violating parties who have performed in full or in part under contracts that have not been rescinded. As discussed below, decisions of the Fifth, Seventh, Eighth and Ninth Circuits support the District Court's cancellation of the note under § 29(b);

a case decided by the Fourth Circuit, a dissenting opinion by Judge Friendly of the Second Circuit, and various district court decisions can be read to support the Court of Appeals' interpretation of the statute.

This Court has addressed § 29(b) only once, in *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375 (1970), and that decision left unresolved the issues raised in this Petition concerning the ability of persons violating the Exchange Act to enforce rights under agreements subject to the voidness provision of the statute. "In *Mills*, the Court enunciated only the general principles governing § 29(b); the case thus provides little guidance to lower courts as to how the provision should be applied in the disparate contexts in which it might be raised." Black, "A Structural Analysis of Section 29(b) of the Securities Exchange Act," 56 U. Chi. L. Rev. 865, 868 (1989) (cited hereinafter as "Black"); *see also id.* at 867 ("it is not clear who can invoke § 29(b) in a given case or what effect it should have when invoked").

Thus, as recently noted in M. Steinberg, *Securities Regulation: Liabilities and Remedies* ¶ 9.03[8] (1993), "[T]here are many significant issues that remain unresolved [under § 29(b)]," including: 1) "[I]s the contract void as a matter of law, or is it simply voidable at the election of the complainant?" and 2) "[W]hether the violating party may be awarded any compensation when he has performed under a 'void' contract?" *Id.* at 9-46.3 & n. 207, *quoting* Gruenbaum and Steinberg, "Section 29(b) of the Securities Exchange Act of 1934: A Viable Remedy Awakened," 48 Geo. Wash. L. Rev. 1, 3 (1979) (cited hereinafter as "Gruenbaum").[4] These two unresolved

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[4] The commentators agree that despite the paucity of decisions of this Court interpreting § 29(b), the statute is an

issues are directly involved in this case and are presented by this Petition.

Mills involved a claim under Section 14(a) of the Exchange Act and Rule 14a-9 for an allegedly misleading proxy solicitation. In the context of that case, where violations of Section 14(a) had been established, this Court expressed the view that Section 29(b) did not automatically render the merger agreement "void," but rather that the agreement was voidable at the option of the victim. The language from *Mills* upon which the Court of Appeals relied in this case, and which has not been consistently interpreted by the courts, is as follows:

> We do not read § 29(b) of the Act . . . as requiring that the merger be set aside simply because the merger agreement is a "void" contract. This language establishes that the guilty party is precluded from enforcing the contract against an unwilling innocent party, but it does not compel the conclusion that the contract is a nullity, creating no enforceable rights in a party innocent of the violation. The lower courts have read § 29(b) . . . as rendering the contract merely voidable at the option of the innocent party. This interpretation is eminently sensible. The interests of the victim are sufficiently protected by giving him the right to rescind; to regard the contract as void where he has not invoked that right would only create the possibility of hardships to him or others without necessarily advancing the statutory policy of disclosure.

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important tool in remedying violations of the Exchange Act. *See* Black at 867 (referring to "the obvious importance of Section 29(b)"); Gruenbaum at 3 (referring to § 29(b) as a "significant section of the federal securities laws").

Mills, 396 U.S. at 386-88 (footnotes and citations omitted). The Court of Appeals misapplied this language from *Mills*, which confirms that § 29(b) provides an "unwilling innocent" party with a defense to a breach of contract claim brought by the defrauding party and expressly states, contrary to the result reached by the Court of Appeals in this case, that "*the guilty party is precluded from enforcing the contract against an unwilling innocent party.*" *Id.* at 387 (emphasis supplied).

The holding by the Court of Appeals – that the District Court was without the power to void Diversicare's rights under the note – is contrary to the express language of § 29(b).[5] The statute provides that every contract made in violation of the Act "shall be void" as

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[5] In addition to holding that the District Court did not have the power to cancel the note because of election of remedies principles, the Court of Appeals suggested that the District Court did not have the power to cancel the note because cancellation of the note would be inconsistent with the jury's finding that Diversicare did not breach any of the representations or warranties in the Stock Purchase Agreement. This was erroneous because the factual finding on which Med-Therapy's invocation of § 29(b) hinged was the finding, expressly made by the jury, that Diversicare defrauded Med-Therapy and violated Rule 10b-5. That the jury found that Diversicare did not "breach" the contract it fraudulently induced Med-Therapy to execute should not have been regarded as a bar to application of § 29(b). Fraud in the inducement and breach of contract are entirely distinct concepts. Therefore, the Court of Appeals' reliance on *In re Lewis*, 845 F.2d 624, 629 (6th Cir. 1988) (*citing Beacon Theatres, Inc. v. Westover*, 359 U.S. 500 (1959), for the proposition that equitable claims must be resolved after, and in light of, the jury's disposition of legal claims), App. 11, was misplaced because cancellation of the note was entirely consistent with the jury's finding that Diversicare committed fraud in violation of the federal securities laws.

regards the rights of the defrauding party. As observed in Gruenbaum, "The language of section 29(b) is manifestly clear: the contract or its performance is void as regards the rights of the violator." Gruenbaum at 16 (footnote omitted); *see id.* at 17 ("[i]n drafting section 29(b), Congress could not have been clearer: the contract or its performance is void as regards the violator's rights"); *see also* Black at 879 (stating that "the strongest case for invoking § 29(b) is the situation where the party seeking to void the contract is both the person for whose benefit the relevant rule [*i.e.*, Rule 10b-5 here] was passed and is in privity of contract with the contracting party"; although the victim may receive a windfall if the violating party has already performed, the court can equitably adjust the § 29(b) remedy if necessary).

In holding that the District Court did not have the power to cancel the note, the only § 29(b) case cited by the Court of Appeals was *Mills*.[6] *Mills*, however, does not suggest that § 29(b) does not mean what it says or that a party who has fraudulently procured an agreement in violation of Rule 10b-5 can enforce its rights under that agreement. Rather, it held that *the victim* may enforce its rights if it chooses to do so: § 29(b) "establishes that the guilty party is precluded from enforcing the contract against an unwilling innocent party, but it does not compel the conclusion that the contract is a nullity, creating no enforceable rights in a party innocent of the violation." *Mills*, 396 U.S. at 386-87. *See*

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[6] Neither *Randall v. LoftsGaarden*, 478 U.S. 647 (1986), nor *Miller v. Premier Corp.*, 608 F.2d 973 (4th Cir. 1979), which were cited by the Court of Appeals, involved the interpretation or application of § 29(b).

Gunter v. Hutcheson, 674 F.2d 862, 875 (11th Cir.) ("[t]he cases [under § 29(b)] go no further than to say that 'void' may be interpreted as 'voidable' in order to assure that the party who has violated the securities laws cannot escape liability under the contract if the victim of the violation insists on enforcement, or if such an interpretation is necessary to avoid other inequities unintended by Congress"), *cert. denied*, 459 U.S. 826 (1982).

In voiding Diversicare's rights under the note, the District Court cited *Sundstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033 (7th Cir.), *cert. denied sub nom. Meers v. Sundstrand Corp.*, 434 U.S. 875 (1977). In *Sundstrand*, the Court of Appeals for the Seventh Circuit held that where a party to a merger agreement (Huarisa) had made misrepresentations and violated Rule 10b-5, the contract was "void as regards the rights of Huarisa under Section 29(b)." *Id.* at 1051. Other decisions supported the District Court's cancellation of Diversicare's rights under the note in this case. In *Regional Properties, Inc. v. Financial and Real Estate Consulting Co.*, 678 F.2d 552 (5th Cir. 1982), the court analyzed the effect of § 29(b) on sales of limited partnerships that violated § 15(a)(1) of the Exchange Act. The court held that "[t]he illegality of the transaction precludes the recovery of damages for breach and any other judgment aimed at enforcement of the tainted contract." *Id.* at 564. Therefore, the court affirmed the ruling of the district court that the violator had no further enforceable rights under the sales agreements and could not recover any fees allegedly owed under the agreements, despite the fact that the violator had completed performance and the limited partnerships already were in operation. *Id.; see also Eastside Church of Christ v. National*

Plan, Inc., 391 F.2d 357, 362-63 (5th Cir.) (transactions in violation of § 15(a)(1) of the Exchange Act "were void *ab initio*" because of § 29(b)), *cert. denied*, 393 U.S. 913 (1968)[7]; *Myzel v. Fields*, 386 F.2d 718, 742 (8th Cir. 1967) ("neither the jury nor the court was required to rescind the agreement, [because] Section 29(b) declares the sale void, once there is found a violation of Rule 10b-5"), *cert. denied*, 390 U.S. 951 (1968); *Errion v. Connell*, 236 F.2d 447 (9th Cir. 1956) (court affirmed cancellation under § 29(b) of notes procured by fraud); *Prudential-Bache Securities, Inc. v. Cullather*, 678 F. Supp. 601, 606 (E.D. Va. 1987) ("Section 29(b) must be understood as barring Pru-Bache from maintaining its contract claim against Cullather if Cullather can establish that the contract is illegal").

The Court of Appeals' decision is rooted in various decisions applying "illegal bargain" principles in situations where the violating party has rendered partial or full performance under the contract. For example, while the case was not cited by the Court of Appeals, Diversicare relied heavily on *Occidental Life Ins. Co. of North Carolina v. Pat Ryan & Associates, Inc.*, 496 F.2d 1255 (4th Cir.), *cert. denied*, 419 U.S. 1023 (1974). In *Occidental*, the trial court found that a seller of stock had violated Rule

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[7] In *Regional Properties*, the Court of Appeals for the Fifth Circuit considered, in light of *Mills*, the viability of its holding in *Eastside Church* that contracts subject to § 29(b) are "void *ab inito*." The court stated: "[T]o the extent our statement in *Eastside Church* could be construed as allowing *a violator* of the Act to rescind a contract, it is inconsistent with *Mills*. This modification of *Eastside Church* does not, however, help Financial, because it was the party, if any, who violated the Act." 678 F.2d at 559 (footnote omitted; emphasis supplied).

10b-5. The trial court directed a verdict in favor of the seller on a claim for payment due. The purchaser appealed, arguing that the seller had no enforceable rights because of § 29(b). The Court of Appeals refused to apply § 29(b) to void the purchaser's rights, stating that § 29(b) codified common law principles of illegal bargain and that the court was reluctant to nullify an executed contract. 496 F.2d at 1266. *See Pearlstein v. Scudder & German*, 429 F.2d 1136, 1149 (2d Cir. 1970) (Friendly, J., dissenting) (stating that § 29(b) was "a legislative direction to apply common law principles of illegal bargain" and that "[t]here has been a conspicuous lack of judicial enthusiasm for the doctrine . . . when there has been performance by the violator"[8]), *cert. denied*, 401 U.S. 1013 (1971); *Gannett Co. v. Register Publishing Co.*, 428 F. Supp. 818, 830-31 (D. Conn. 1977) (holding that § 29(b) codified the principles of illegal bargains and that an agreement induced by fraud in violation of the federal securities laws "is not *ipso facto* void"); *Freeman v. Marine Midland Bank – New York*, 419 F. Supp. 440, 453 (E.D.N.Y. 1976) (following Judge Friendly's dissent in *Pearlstein*).

Petitioners submit that the decision of the Court of Appeals and other cases suggesting that a violating party may enforce its rights under an agreement subject to § 29(b) are contrary to the express terms of the statute. As stated in Gruenberg:

> The interpretation of section 29(b) in these opinions and the decisions that follow them is

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[8] As support for this proposition, Judge Friendly cited *Kelly v. Kosuga*, 358 U.S. 516 (1959), and *Bruce's Juices, Inc. v. American Can Co.*, 330 U.S. 743 (1947). The reliance on these cases was dubious. *See* Gruenbaum at 14-15 n.68.

> questionable. The language of section 29(b) is manifestly clear: the contract or its performance is void as regards the rights of the violator. Under section 29(b), the violating party cannot enforce the contract or sue for damages when the non-offending party elects to terminate the contract. . . . In drafting section 29(b), Congress could not have been clearer: the contract or its performance is void as regards the violator's rights. The innocent victim retains all rights and remedies.
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> * * *
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> In view of the clear language of section 29(b), the lack of legislative history supporting the illegal bargain rationale, and the way that the section 29(b) remedy complements other remedies provided by the Exchange Act, the conclusion appears inescapable that section 29(b) means exactly what it says.

Gruenberg at 16-17, 19 (footnotes omitted).

Petitioners respectfully submit that this Court should review the decision of the Court of Appeals to provide the lower courts with guidance concerning the application of § 29(b) and to resolve the conflict among the courts of appeals and district courts as to the meaning of the voidness provision of § 29(b).

2. The Court of Appeals' Decision Deprives the District Courts of Discretion to Fashion Relief for Violations of the Securities Laws and is Contrary to Principles Established by this Court in *Mills* and Other Cases.

The federal securities laws are to be construed flexibly to achieve their remedial purposes. *Affiliated Ute*

Citizens v. United States, 406 U.S. 128, 151 (1972). Therefore, when violations of the federal securities laws are established, as occurred in this case, the district courts have broad legal and equitable powers to order the relief necessary to effectuate the purposes of the securities laws. *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 386 (1970); *see SEC v. Manor Nursing Centers, Inc.*, 458 F.2d 1082, 1103-04 (2d Cir. 1972) ("[o]nce the equity jurisdiction of the district court has been properly invoked by a showing of a securities law violation, the court possesses the necessary power to fashion an appropriate remedy"). As this court observed in *J.I. Case Co. v. Borak*, 377 U.S. 426 (1964), an action for violations of the Exchange Act:

> We, therefore, believe that under the circumstances here it is the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose. . . . It is for the federal courts "to adjust their remedies so as to grant the necessary relief" where federally secured rights are invaded. "And it is also well settled that where legal rights have been invaded, and a federal statute provides for a general right to sue for such invasion, federal courts may use any available remedy to make good the wrong done."

Id. at 433, *quoting Bell v. Hood*, 327 U.S. 678, 684 (1946).[9] As observed by this Court in *J.I. Case*, Section 27 of the

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[9] Because of the substantial discretion that the district courts possess in fashioning relief under the federal securities laws, the remedies awarded for violations of those laws are normally subjected to very narrow appellate review under an abuse of discretion standard. *E.g., SEC v. Certain Unknown Purchasers of Common Stock of Santa Fe Int'l Corp.*, 817 F.2d 1018, 1020 (2d Cir. 1987), *cert. denied*, 484 U.S. 108 (1988). *See Lemon v.*

Exchange Act, 15 U.S.C. § 78aa, specifically gives district courts the authority to fashion appropriate legal and equitable remedies. 377 U.S. at 433.

Affording the district courts considerable discretion when applying the voidness provision of § 29(b) is particularly warranted in circumstances such as here because cancellation of a written instrument is an equitable remedy. *Kamen v. Kemper Financial Services, Inc.*, 908 F.2d 1338, 1351 (7th Cir.), *cert. denied*, 498 U.S. 999 (1990). Indeed, this Court emphasized in *Mills* that equitable considerations are critical when § 29(b) is invoked: "In selecting a remedy the lower courts should exercise 'the sound discretion which guides the determinations of courts of equity,' keeping in mind the role of equity as 'the instrument for nice adjustment and reconciliation between the public interest and private needs as well as between competing private claims.' " *Mills*, 396 U.S. at 386; *see also id.* at 388 ("[t]he merger should be set aside only if a court of equity concludes, from all the circumstances, that it would be equitable to do so"). As the court in *Yamamoto v. Omiya*, 564 F.2d 1319, 1324 (9th Cir. 1977), observed: "Despite the discussion of possible voidability in *Mills*, . . . the Court could not have been clearer in its refusal to tie the hands of the trial court. To us, *Mills* indicates that the decision on remedy should be left to the discretion of the District Court." Notwithstanding these principles, the Court of Appeals, in reviewing the District Court's cancellation of the note, did not evaluate whether

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Kurtzman, 411 U.S. 192, 200 (1973) ("[i]n shaping equity decrees, [a] trial court is vested with broad discretionary power; appellate review is correspondingly narrow").

the District Court abused its discretion; rather, it flatly held that the District Court did not have the power to cancel the note. Such a holding was antithetical to the principle that in fashioning relief for violations of the federal securities laws, the District Court had the discretion to order equitable relief.

Exercising its discretion in affording Med-Therapy relief for Diversicare's violations of Rule 10b-5, the District Court determined that it was appropriate to cancel Diversicare's rights under the note. App. 22-24. This action was fully warranted under the traditional measure of damages for Rule 10b-5 claims – *i.e.*, the difference between the purchase price paid for the stock and the true value of the stock at the time of the transaction. *E.g.*, *Occidental Life Ins. Co. of North America v. Pat Ryan & Associates*, 496 F.2d 1255, 1264 (4th Cir.), *cert. denied*, 419 U.S. 1023 (1974). Med-Therapy introduced expert testimony showing that the actual value of the National stock at the time of the transaction was zero. Thus, as observed by the District Court, cancellation of the note would not "result in any windfall or double recovery to Med-Therapy." App. 24.[10]

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[10] This concern, which was expressed in *Occidental*, was inapplicable in this case because at trial Med-Therapy sought to recover as damages the difference between the cash paid at closing ($750,000) and the actual value of the National stock ($0), rather than the difference between the full amount of the consideration ($1.45 million – *i.e.*, the $750,000 in cash plus the $700,000 note) and the actual value of the stock. If the latter approach had been pursued by Med-Therapy, a double recovery would have occurred if Med-Therapy recovered $1.45 million in damages *and* had the note cancelled. As the District Court correctly observed, that did not occur in this case and cancellation of the note did not result in a double recovery for Med-Therapy.

As noted above, in those cases where literal application of § 29(b) would provide a harsh result because the violating party has already performed under a contract the district courts can employ their equitable powers to make any necessary adjustments between the parties. *See* Gruenbaum at 14 n.68, 19; Black at 879, 888. This, however, was not such a case and the district court properly acted within its discretion in finding that cancellation of the note would not give Med-Therapy a windfall or double recovery. App. 24. The Court of Appeals did not differ with this conclusion, nor did it express any reason why cancellation of the note would be inequitable.

The Court of Appeals' decision illustrates why substantial discretion resides within the district courts in fashioning relief under the federal securities laws. The Court of Appeals' opinion does not reflect any effort to determine whether cancellation of the note was appropriate under the circumstances of the case; rather, it relies on a mechanical application of § 29(b) whereby a party who has not filed a rescission action is absolutely precluded from asking a district court to use its equity powers to void the violating party's rights under an instrument procured through fraud. Such a holding deprives the district courts of their equitable powers under § 29(b) and should not be permitted to stand.

CONCLUSION

For the foregoing reasons, this Court should issue a writ of certiorari to the United States Court of Appeals for the Fourth Circuit to review the decision below.

Respectfully submitted,

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UNPUBLISHED

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

MED-THERAPY REHABILITATION SERVICES, INCORPORATED, *Plaintiff-Appellee,* v. DIVERSICARE CORPORATION OF AMERICA, *Defendant & Third Party Plaintiff-Appellant,* v. N S & H, INCORPORATED; BRIAN CENTER MANAGEMENT CORPORATION, *Third Party Defendants-Appellees.*	No. 93-1176

MED-THERAPY REHABILITATION SERVICES, INCORPORATED, *Plaintiff-Appellant,* v. DIVERSICARE CORPORATION OF AMERICA, *Defendant & Third Party Plaintiff-Appellee,* v. N S & H, INCORPORATED; BRIAN CENTER MANAGEMENT CORPORATION, *Third Party Defendants.*	No. 93-1210

Appeals from the United States District Court
for the Western District of North Carolina, at Statesville.
Richard L. Williams, Senior District Judge,
sitting by designation.
(CA-91-28)

Argued: December 7, 1993

Decided: February 3, 1994

Before MURNAGHAN, WILKINSON, and WILKINS,
Circuit Judges.

Affirmed in part, reversed in part, and remanded by unpublished per curiam opinion.

COUNSEL

ARGUED: Glenn Benton Rose, HARWELL, HOWARD, HYNE, GABBERT & MANNER, P.C., Nashvile, Tennessee, for Appellant. Michael Jackson Betts, REED, SMITH, SHAW & MCCLAY, Pittsburgh, Pennsylvania, for Appellees. **ON BRIEF:** Lin S. Howard, D. Alexander Fardon, HARWELL, HOWARD, HYNE, GABBERT & MANNER, P.C., Nashville, Tennessee; James C. Smith, RAYBURN, MOON & SMITH, Charlotte, North Carolina, for Appellant. Mary J. Hackett, REED, SMITH, SHAW & MCCLAY, Pittsburgh, Pennsylvania, for Appellees.

Unpublished opinions are not binding precedent in this circuit. See I.O.P. 36.5 and 36.6.

OPINION

PER CURIAM:

Diversicare Corporation of America (Diversicare) sold the stock of National Speech and Hearing Services, Inc. (National) to Med-Therapy Rehabilitation Services, Inc. (Med-Therapy) in April 1988. Pursuant to a stock purchase agreement (the "Agreement"), Med-Therapy paid $750,000 in cash for National. In addition, Med-Therapy caused National to sign a promissory note to Diversicare for $700,000 (the "Note"). Med-Therapy and its parent corporation, Brian Center Management, Inc., guaranteed the payment of the Note.

In April 1991, Med-Therapy brought suit against Diversicare claiming that Diversicare breached its agreement with Med-Therapy; violated § 10(b) of the Securities Exchange Act of 1934; committed common law fraud; violated the North Carolina and Tennessee Securities Acts; and engaged in negligent misrepresentation and omissions. Med-Therapy sought damages, indemnity under the terms of the Agreement, and attorney's fees. Diversicare filed a counter-claim against Med-Therapy and a third-party complaint against National and Brian Center in an attempt to recover the amount due under the Note.

This case was tried before a jury in October 1992. In response to Diversicare's motion for judgment as a matter of law, the district court dismissed Med-Therapy's state securities law and negligent misrepresentation and omission claims. The court submitted the rest of the claims to the jury on special verdict forms.

The jury found for Med-Therapy on the federal securities and the common law fraud claims, awarding the company $300,000 for the § 10(b) violation, $252,527 for common law fraud, and $1,000 in punitive damages. The jury found against Med-Therapy on the breach of contract claim because Diversicare did not breach any representation or warranty made in Article Four of the Stock Purchase Agreement. Finally, the jury awarded Diversicare the entire amount due under the note – $552,527.[1] The net result of the jury's verdict was a $1,000 victory for Med-Therapy.

Both parties submitted several post-trial motions. In a Final Order and Memorandum Opinion, the United States District Court for the Western District of North Carolina granted Med-Therapy judgment on the federal securities fraud and common law fraud claims insofar as liability was concerned. Despite the jury's verdict, however, the court cancelled the Note, denying Diversicare's motion for judgment on its counter-claim for the amount due under the Note plus interest.[2] In addition, the court

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[1] Section 3.2 of the Stock Purchase Agreement provided for possible offsets to the $700,000 Note depending on National's future collection of accounts receivable and on the accuracy of a preliminary balance sheet. Although Med-Therapy claimed at trial that a $1,500,000 downward adjustment was warranted, the jury accepted the testimony of Diversicare's Chief Financial Officer that the Note should be adjusted by only $147,473, awarding Diversicare the remaining $552,527. That amount precisely equalled the sum of $300,000 and $252,527 awarded to Med-Therapy by the jury.

[2] Diversicare made a post-trial motion for a judgment on its counterclaim under the Note for both principal ($552,527) and interest, so the total amount sought came to $776,507. The

granted Med-Therapy's motion for declaratory judgment requiring Diversicare to indemnify Med-Therapy for any liability that might arise out of claims that might hereafter be asserted against Med-Therapy relating to National's pre-acquisition cost reports. Denying Med-Therapy's motion for a new trial, and refusing to aggregate the jury's verdicts in favor of Med-Therapy, the court awarded Med-Therapy $301,000[3] and an additional $108,480 in pre-judgment interest. In contrast to the $1,000 victory that resulted from the jury's verdict, Med-Therapy won a $497,480 award plus indemnification as a result of the district court's Order.[4]

Both Med-Therapy and Diversicare have appealed discrete portions of the district court's Order. Med-Therapy has appealed the district court's denial of its motion for a new trial on the issue of damages. In the alternative, Med-Therapy has argued that the district court should have aggregated the jury's verdicts in favor of Med-Therapy on the federal securities and common law fraud claims (rendering a total award of $552,527 as the jury apparently intended rather than the $300,000 award the

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district court denied that motion. Diversicare also requested $322,022.09 in attorney's fees and costs which the court denied.

[3] In an Amended Final Order, the judge stated that the interest due on the $300,000 judgment was $88,000. He entered judgment for Med-Therapy in the amount of $388,000 on January 25, 1993. In April of 1993, Judge Williams amended the order once again to reflect the $1,000 punitive damages award which had been left out of the January Order. The final total was $389,000.

[4] The total is obtained by adding the $389,000 to the $108,480 pre-judgment interest award.

judge entered). Diversicare, on the other hand, has appealed the district court's order that effectively rescinded the stock purchase agreement which Med-Therapy had asked the court to enforce. In addition, Diversicare has appealed the district court's order requiring Diversicare to indemnify Med-Therapy for the losses that might arise out of National's medicare liabilities in that such a requirement 1) is premature and 2) contradicts the jury's finding that Diversicare did not breach the Agreement.[5]

Discussion

In an apparent attempt to resolve the situation in an equitable manner, the trial court accepted only part of the jury's verdict and rejected the other part. As illustrated above, such a resolution significantly altered the outcome intended by the jury and, in some cases, contradicted the jury's factual findings. We reverse in part and affirm in part the trial court's order and remand for reinstatement of the jury verdict as rendered.

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[5] Because Diversicare did not breach the contract, Med-Therapy was not entitled to indemnification under Section 10.2(a) of the Agreement. Rather, the judge awarded what appears to be "implied-in-law" indemnity as an equitable remedy for losses suffered by Med-Therapy arising out of National's cost reports. The indemnification issue, as illustrated below, is problematic in that Med-Therapy has not been held liable for National's overpayment liabilities.

I. *Med-Therapy's Motion for a New Trial on Damages*

The district court did not err in denying Med-Therapy's motion for a new trial on damages. In *Walker v. Crigler*, 976 F.2d 900, 903 (4th Cir. 1992), we held that a trial court's "denial of a motion for a new trial should be reversed only when abuse of discretion on the part of the trial court is shown in its determination that '[t]he jury's verdict was not against the clear weight of the evidence. . . .' "

In denying Med-Therapy's motion for a new trial on damages, the judge held that the jury had the prerogative to disregard the "uncontroverted" testimony of Med-Therapy's expert witness. In addition, the judge found that "[t]he jury could certainly have concluded, consistent with the evidence presented at trial, that the stock of [National] was not worthless; and/or that Med-Therapy failed to mitigate whatever damages it may have suffered."[6] The judge continued. "What is obvious to the Court is that Med-Therapy, having opted for a jury trial on a rather complex securities dispute (as it is entitled to

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[6] Evidence adduced at trial suggested that Med-Therapy lacked diligence in pursuing the appeals of the Notices of Program Reimbursement (NPRs) submitted to National by Mutual of Omaha. Issued when adjustments become final, the NPR is the first statement of the amount the provider actually owes on its Medicare settlement. A provider can appeal an NPR to the Provider Reimbursement Review Board within 120 days. The provider can also ask the intermediary to re-open the relevant cost report within three years of the date the intermediary issues the report. Although Med-Therapy filed several appeals consistent with its obligation under the terms of the Agreement, it failed to prosecute those appeals and they were dismissed.

do), and having failed to 'ring the bell' with the jury, now wishes to have a second go at it." Because the evidence adduced at trial supports the trial court's conclusions, the trial court did not abuse its discretion in denying the motion for a new trial on the damages issue.

II. *The Amount Due Under the Note*

The district court erred by cancelling the Note guaranteed by Med-Therapy as part of the underlying transaction. That ruling contradicts the jury's finding that Diversicare did not breach the contract, and that Med-Therapy still owed Diversicare the amount due under the Note.

Med-Therapy elected to enforce the Agreement by suing for damages for fraud on the basis of that Agreement. A party who brings suit on the basis of an allegedly fraudulent contract must choose to prove fraud and seek recovery under the terms of the contract or to rescind the contract and pursue restitution if applicable. A party may not do both. In *Miller v. Premier Corp.*, 608 F.2d 973, 983 (4th Cir. 1979), we delineated a complainant's choice of remedies emphasizing "the principle that a party to a contract who sues to recover damages for fraud in its inducement rather than seeking rescission has thereby affirmed the contract and consequently assumed liability for its breach."[7]

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[7] In that case, we found that "it was perfectly possible for Premier to recover on its contract claim despite being liable for damages for fraud in its inducement." *Id.*

Once a contract is affirmed, either party can sue under the agreement to enforce any rights arising under that agreement. One party may be successful on a fraud claim while the opposing party is successful on a breach of contract claim. *Miller*, 608 F.2d at 983.

The principle applies to both common law fraud and federal securities fraud violations. In *Randall v. LoftsGaarden*, 478 U.S. 647, 662 (1986), the Supreme Court wrote that a § 10(b) plaintiff, in some circumstances, may "choose between 'undoing the bargain (when events since the transaction have not made rescission impossible) or holding the defendant to the bargain by requiring him to pay [out-of-pocket] damages.' "[8]

In its Order cancelling the Note, the district court relied on language from § 29(b) of the 1934 Act which suggests that a contract made in violation of that Title is void. Although the judge cited the language of § 29(b) correctly, the courts have interpreted the provision more loosely. Section 29(b) provides: "Every contract made in violation of any provision of this chapter or of any rule or regulation thereunder . . . shall be void. . . . " 15 U.S.C. § 78cc(b).

In *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 387 (1970), the Supreme Court wrote that it did not read

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[8] The Supreme Court cited *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 155 (1972), which involved § 10(b) violations, for the principle that the correct measure of damages under § 28 of the Act, 15 U.S.C. § 78bb(a), is the difference between the fair value of all that the plaintiff received and the fair value of what he would have received had there been no fraudulent conduct. *Id.* at 661-62.

§ 29(b) of the Act as requiring that a given transaction be set aside simply because the agreement giving rise to that transaction is a "void" contract. The language of § 29(b)

> establishes that the guilty party is precluded from enforcing the contract against an unwilling, innocent party, but it does not compel the conclusion that the contract is a nullity, creating no enforceable rights even in a party innocent of the violation. The lower federal courts have read § 29(b) . . . as rendering the contract *merely voidable* at the *option* of the innocent party. . . . This interpretation is eminently sensible. The interests of the victim are sufficiently protected by giving him the right to rescind. . . .

Id. at 387-88 (citations omitted) (emphasis added).

The jury specifically affirmed Med-Therapy's obligation to Diversicare under the Note. Although it awarded Med-Therapy damages for fraud, simultaneously it found that Diversicare did not breach the contract and that Med-Therapy owed Diversicare the remaining $552,527. The judge voided the jury's verdict in favor of Diversicare on its claim for the amount due under the Note by entering an order cancelling the Note pursuant to § 29(b). The judge did not have the authority to disregard the jury's factual findings.

"When a party has the right to a jury trial on an issue involved in a legal claim, the judge is of course bound by the jury's determination of that issue as it affects his disposition of an accompanying equitable claim." *Lincoln v. Board of Regents*, 697 F.2d 928, 934 (11th Cir.), *cert. denied*, 464 U.S. 826 (1983) (holding that the district court's judgment in that case was not inconsistent with

the jury's verdict). Although the judge may have broad legal and equitable powers to order the relief necessary to effectuate the purposes of the securities laws under *Mills v. Electric Auto-Lite*, those powers are circumscribed when the judge is fashioning that relief subsequent to a jury verdict. The facts on which the judge bases his equitable or declaratory relief must not contravene the facts as found by the jury. *In re Lewis*, 845 F.2d 624, 629 (6th Cir. 1988) ("[a]ccording to the progeny of *Beacon Theatres, Inc. v. Westover*, 359 U.S. 500 (1959), the legal claim . . . must be tried first before a jury and the equitable claim resolved subsequently *in light* of the jury's determination of the legal claim." *Id.*)[9]

III. *Indemnification*

The district court also erred by ordering Diversicare to indemnify Med-Therapy against liability that might arise from potential claims when 1) the jury found that Diversicare did not breach the contract; and 2) no such claims have been asserted.

Section 10.2(a) of the Stock Purchase Agreement provided for contractual indemnification in the event of breach by either party. Med-Therapy sought indemnification under this provision. The jury found that Diversicare did not breach the agreement. Thus, Med-Therapy was

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[9] *Lewis* continues, " '[i]t is well-settled that the "court may not make findings" contrary to or inconsistent with the jury's resolution . . . of that same issue as implicitly reflected in its general verdict.' " *Id.* at 629. In the instant case, the district court contravened the findings explicitly stated in the jury's special verdict.

not entitled to contractual indemnification. Rather, the court entered a declaratory judgment awarding Med-Therapy "implied-in-law" or equitable indemnification. The Declaratory Judgment Act did not give the judge the authority to disregard the jury's factual findings.

In addition, the district court judge entered the declaratory judgment for Med-Therapy in anticipation of that company's potential liability. National does not have the assets to satisfy the claims, giving rise to "the *possibility* that the Government may assert claims against Med-Therapy." As of the date of the Order, the government had not asserted any claims against Med-Therapy. Under the Declaratory Judgment Act, the moving party must demonstrate an actual controversy:

> [i]n the normal indemnity situation, where, as here, no contractual duty to defend exists, no duty to do anything arises until the alleged indemnitee is adjudged liable.

Cunningham Bros., Inc. v. Bail, 407 F.2d 1165 (7th Cir.), *cert. denied*, 395 U.S. 959 (1969). In addition, the Restatement of Restitution explains that one is entitled to indemnity only if one discharges a debt that he or she owes.

> A person who, in whole or in part, has discharged a debt which is *owed by him* but which as between himself and another, should have been discharged by the other, is entitled to indemnification from the other, unless the payor is barred by the wrongful nature of his conduct.

Restatement of Restitution § 76. Med-Therapy did not produce any evidence that Medicare has filed or is currently filing claims against Med-Therapy. Thus, aside

from the district court's order's inconsistency with the jury verdict, that order was premature.

IV. *Aggregation of Damages*

The district court awarded Med-Therapy only $300,000, holding "as a matter of law" that the larger award for the federal securities violation subsumed the smaller award for common law fraud. The court held that recovery on both counts would constitute double recovery because both claims arose from the same allegation of wrong-doing and harm. Med-Therapy has appealed this portion of the judge's order.

Under *Richmond v. Madison Management Group, Inc.*, 918 F.2d 438, 461 (4th Cir. 1990),

> [a] district court may aggregate verdicts without violating the seventh amendment right to a jury trial if the verdicts are " 'logical and probable' only if they are aggregated." . . . The requirement that aggregation occur only if the aggregated verdict is what the jury *must* have intended stems from the fact that a district court's reexamination of record evidence is barred by the Seventh Amendment.

Med-Therapy has argued that the jury clearly intended to award Med-Therapy a total of $552,527 for both claims; that, under *Richmond*, it is logical and probable to aggregate the two awards; and that the trial court erred by refusing to do so.

The district judge acknowledged *Richmond's* "logical and probable" language in his Order. He held, however, that permitting Med-Therapy to recover on both claims

would constitute double recovery. The question whether damage awards are duplicative is one of fact. As such, it is reviewable under the clearly erroneous standard. *U.S. Indus., Inc. v. Touche Ross & Co.*, 854 F.2d 1223, 1259 n.53 (10th Cir. 1988).

In refusing to aggregate the verdicts, the judge contravened the intent of the jury. The jury clearly intended the parties to come out "in a wash" aside from Med-Therapy's $1000 punitive damages award.[10] In an attempt to award Med-Therapy a total of $553,527 (including punitive damages), the jury apportioned the money among the claims contained in the special verdict forms provided by the judge: $300,000 for the federal securities violation; $252,527 for the common law fraud; and $1000 for punitive damages. Because the awards in favor of each party are identical with the exception of the $1,000 punitive damages award for Med-Therapy, it is an inescapable fact that the jury intended to award Med-Therapy $552,527 for Diversicare's fraud. The verdicts are "logical and probable" under *Richmond* only if they are aggregated.

The jury, then, did not award duplicative damages. Rather, the jury arrived at a lump sum damages decision and appears to have divided it in order to give Med-Therapy something on each claim. The court did not inform the jury prior to its deliberation that such an action would result in the elimination of the lesser award. The court instructed the jury with respect to Med-Therapy's federal securities fraud claim and potential out-of-

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[10] The district judge acknowledged that point in his Order.

pocket and consequential damages. The court also instructed the jury as to the six elements of common law fraud under North Carolina law and potential damages. The district court, however, did not instruct the jury as to the "duplication" issue as it affected the federal securities and common law fraud awards.

Aside from the fact that the jury intended to give Med-therapy $552,527, it appears that the district judge, in exercising his discretion under *Richmond*, was unduly influenced by his own decision to cancel the Note, rendered in response to Med-Therapy's post trial motion, effectively eradicating the verdict in favor of Diversicare.[11]

Our ultimate purpose in reaching a result in the case, is to adhere fully to the jury's verdict. Because aggregation seems to accomplish the most equitable result, and a result that is consistent with the jury's verdict, we hold that the trial court's order with respect to aggregation should be reversed, and the jury's verdict reinstated as rendered.

V. *Constitutional Claims*

We have held in *Cooke v. Manufactured Homes, Inc.*, 998 F.2d 1256 (4th Cir. 1993), that § 27A of the Securities Exchange Act of 1934 (as amended 15 U.S.C.A.

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[11] It is clear from the record that the judge believed a verdict in favor of Med-Therapy on the fraud claims would be inconsistent with an award for Diversicare for the amount due under the Note. As illustrated above, under *Miller*, the former does not preclude the latter.

§ 78aa-1(a)), is constitutional. As such, Med-Therapy's § 10b claim was timely filed, and Diversicare's argument that we reconsider *Cooke* is without merit.

VI. *Conclusion*

The judgment is accordingly affirmed with respect to the district court's denial of a new trial on the damages issue. The parts of the judgment cancelling the Note, requiring indemnification by Diversicare, and refusing aggregation of awards in favor of Med-therapy are reversed, and we remand for reinstatement of the jury verdict as rendered.

AFFIRMED IN PART, REVERSED IN PART, AND REMANDED

IN THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF NORTH CAROLINA

Statesville Division

MED-THERAPY REHABILITATION SERVICES, INC.,	)	
Plaintiff,	)	**CIVIL ACTION NO. ST-C-91-28-P**
v.	)	
DIVERSICARE CORPORATION OF AMERICA,	)	**(Filed Nov. 30, 1992)**
Defendant, Counter-Plaintiff and Third-Party Plaintiff,	)	
v.	)	
NATIONAL SPEECH AND HEARING SERVICES, INC., AND BRIAN CENTERS MANAGEMENT, INC.	)	
Third-Party Defendants.	)	

MEMORANDUM OPINION

This matter is before the Court on the respective post-trial motions of the four parties that are involved in this lawsuit. The Court's jurisdiction is predicated on the federal questions presented. The plaintiff, Med-Therapy Rehabilitation Services, Inc. ("Med-Therapy"), and the third-party defendants, National Speech and Hearing Services, Inc. (NS&H") and Brian Center Management Corporation ("Brian Center"), have (collectively or

individually, by Med-Therapy alone) moved for declaratory judgment on two counts, and for a new trial on three counts.

Med-Therapy requests declaratory relief, first, requiring indemnification by DCA on claims relating to the pre-acquisition cost reports filed by NS&H; and second, cancelling the Note and declaring that DCA has no rights thereunder. Med-Therapy also requests a new trial with respect to first, damages under its Rule 10b-5 and common law fraud claims; second, DCA's counterclaim and third-party claims under the Note (in the event that the Court does not provide the declaratory relief requested); and third, its claims under the North Carolina and Tennessee Securities Acts and for negligent misrepresentations and omissions (claims that the Court declined to submit to the jury). Finally, Med-Therapy has filed a conditional motion for attorneys' fees and costs.

The defendant, counter-plaintiff and third-party plaintiff, Diversicare Corporation of America ("DCA"), in turn, has moved for entry of judgment as a matter of law on all four claims against DCA, in addition to its counterclaim. DCA also requests $322,022.09 in attorneys' fees and costs.

For the reasons stated below, the Court: (i) GRANTS Med-Therapy's motion for a declaratory judgment requiring indemnification from DCA; (ii) GRANTS Med-Therapy's, NS&H's and Brian Center's motion for a declaratory judgment canceling the Note; (iii) DENIES Med-Therapy's motions for a new trial on its the [sic] various claims; (iv) DENIES IN PART AND GRANTS IN PART, DCA's motion to dismiss as a matter of law, Med-

Therapy's fraud and federal securities claims, upon which the latter prevailed at trial; and (v) DENIES DCA's motion for a judgment on in [sic] its counterclaim under the Note (for principal and interest in an amount of $776,507).

The Court has not considered DCA's motions to dismiss various claims by Med-Therapy, insofar as they simply affirm decisions already rendered by the Court (or by the jury), nor does it consider Med-Therapy's conditional motion for attorneys' fees. Finally, DCA's motion for attorneys' fees and costs is DENIED.

FACTUAL BACKGROUND:

This is a securities fraud action, arising from Med-Therapy's purchase of 100% of the stock of NS&H from DCA in April, 1988. NS&H is a provider, under Medicare, of speech and hearing therapy services to hospitals and nursing homes. Med-Therapy asserted six claims against DCA, viz: (i) violations of section 10(b) of the 1934 Act, and Rule 10b-5 thereunder; (ii) violations of the North Carolina Securities Act; (iii) violations of the Tennessee Securities Act; (iv) common law fraud; (v) negligent misrepresentation and omissions; and (vi) breach of contract.

DCA, in turn, instituted a third-party action against NS&H and Brian Center for amounts allegedly due under the promissory note (the "Note") executed by NS&H, and guaranteed by Brian Center, in connection to the stock purchase transaction. DCA's action also included a counterclaim against Med-Therapy, as guarantor of the Note.

A jury trial was conducted on October 15, 16 and 19, 1992. At the conclusion of the plaintiff's case-in-chief, the Court granted DCA's motion for judgment as a matter of law on Med-Therapy's North Carolina and Tennessee Securities Acts claims, as well as those for negligent misrepresentations and omissions. The jury was therefore presented with Med-Therapy's federal securities, common law fraud and breach of contract claims. The jury found: (i) in favor of Med-Therapy on its Rule 10b-5 and common law fraud causes of action, with compensatory damages in the amounts of $300,000 and $252,527, respectively, and $1,000 in punitive damages; (ii) in favor of DCA on Med-Therapy's breach of contract claim; and (iii) in favor of DCA on its counterclaim under the Note, in the amount of $552,527.

DISCUSSION:

I. THE MOTIONS FOR MED-THERAPY, NS&H AND BRIAN CENTER

1. Motion under Fed. R. Civ. P. 57 for a Declaratory Judgment Requiring DCA to Indemnify Med-Therapy

Med-Therapy requested the Court, in its Amended Complaint, to "enter a declaratory judgment pursuant to 28 U.S.C. § 2201 requiring [DCA] to indemnify, defend and hold Med-Therapy harmless against any and all loss, expense and damages arising from the cost reports filed by [NS&H] for the periods ending December 31, 1984, December 31, 1985, December 31, 1986 March 31, 1987 and March 31, 1988." The Court deferred ruling on Med-

Therapy's request for declaratory judgment, pending the jury's determination on its fraud claim against DCA.

The Court now rules in favor of Med-Therapy on this issue, pursuant to section 27 of the Securities Exchange Act of 1934 ("the 1934 Act" or "the Act").[1] It has long been recognized that the federal securities laws are to be construed flexibly to achieve their remedial purposes. *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 151 (1972). In addition, section 27 grants the Court broad powers in providing legal and equitable remedies resulting from violations of the Act and Rule 10b-5. Hence, when a violation is established, the Court may order any relief necessary to effectuate the purposes of the securities laws. *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 386 (1970). *See also J.I. Case Co. v. Borak*, 377 U.S. 426 (1964) (" '[I]t is also well settled that where legal rights have been invaded, and a federal statute provides for a general right to sue for such invasion, federal courts may use any available remedy to make good the wrong done.' " *Id.* at 433, quoting *Bell v. Hood*, 327 U.S. 678, 684 (1946)).

Furthermore, the Federal Declaratory Judgment Act[2] enables the Court to fashion relief to Med-Therapy necessary to protect it from the potential liabilities to which it has been subjected as a result of DCA's breach. The Court finds that an actual case or controversy is presented in the instant action, as statutorily required. The evidence at trial demonstrated that Med-Therapy will not be afforded complete relief unless it is protected against any claims

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[1] 15 U.S.C. § 78aa (1992).

[2] 28 U.S.C. § 2201 (1992).

that may be asserted against it as a result of the defects in the cost reports at issue.

There was also testimony at the trial establishing that claims amounting to approximately $1.1 million have been made by the United States Government against NS&H with respect to its cost reports. The evidence also showed that NS&H does not have sufficient assets to satisfy these claims, giving rise to the possibility that the Government may assert claims against Med-Therapy. Med-Therapy is thus entitled, pursuant to the jury's findings that DCA violated the federal securities laws, to the relief that it seeks on its motion.

Accordingly, the Court hereby enters a declaratory judgment requiring DCA to indemnify, defend and hold Med-Therapy harmless against any claims that may be asserted by the Government with respect to NS&H's cost reports for the years alleged in the Amended Complaint.

2. Motion under Fed. R. Civ. P. 57 and 58 for a Declaratory Judgment Cancelling the Note and Entry of Judgment in Favor of Med-Therapy, Brian Center and NS&H

Med-Therapy, in the Amended Complaint, also requested "declaratory judgment pursuant to 28 U.S.C. § 2201 cancelling the Note and declaring that DCA has no rights thereunder." Again, the Court finds that Med-Therapy, Brian Center and NS&H are entitled to a declaratory judgment cancelling the Note, pursuant to section 29(b) of the Act. The Act states, in pertinent part:

> Every contract made in violation of any provisions of this title or of any rule or regulation

> thereunder . . . shall be void . . . as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract.

15 U.S.C. § 78cc(b). *See also Sundstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033, 1051 (7th Cir. 1977) (counterclaim under stock option transfer agreement dismissed because agreement was procured by fraud in violation of Rule 10b-5 and was hence void under § 29(b)), *cert. denied*, 434 U.S. 875 (1977); *Prudential-Bache Secur., Inc. v. Cullather*, 678 F. Supp. 601, 606 (E.D. Va. 1987) ("section 29(b) must be understood as barring Pru-Bache for maintaining its contract claim against Cullater if Cullater can establish that the contract is illegal.")

Further support for this position is provided by the jury's verdict that DCA engaged in common law fraud.[3] It is an established principle of contract law that fraud in the inducement of a contract vitiates the contract. *See American Laundry Machinery Co. v. Skinner*, 225 N.C. 285, 34 S.E.2d 190, 192 (1945); *Parker v. Bennett*, 32 N.C. App. 46, 231 S.E.2d 10, 13-14, *cert. denied*, 292 N.C. 266, 233 S.E.2d 393 (1977).

In *Colonial Lincoln-Mercury, Inc. v. Musgrave*, 749 F.2d 1092 (4th Cir. 1984), the buyer of the assets of an automobile dealership and of stock of a related leasing company brought an action against the seller for fraud. The seller counterclaimed on the basis that the buyer had

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[3] The Court has previously ruled that the common law claims in this action are governed by North Carolina law.

breached an obligation to make payments under the purchase agreement. The Fourth Circuit held that "the jury's determination of the fraud issue on plaintiff's claims would be determinative of liability on both the plaintiff's claims and the defendant Borough's counterclaims." *Id.* at 1101.

Similarly, in *Kim v. Professional Business Brokers Ltd.*, 74 N.C. App. 48, 328 S.E.2d 296 (1985), a fraud action, the court held that the trial court did not err in declining to submit to the jury counterclaims that were based on the failure of the plaintiff to pay notes:

> If the jury found a defendant engaged in fraud, then that defendant was not entitled to recover on his note . . . Conversely, if the jury found no fraud, defendants were entitled to recover on the note. The jury found that all defendants had engaged in fraud; therefore, the court's failure to submit issues on the counterclaim was not prejudicial error.

Id. at 50-51, 328 S.E.2d at 298-99 (citations omitted).

Although DCA cites several cases for the common law principle of election of remedies, those cases are readily distinguishable from the present one, which involves a breach of federal securities law. Thus, cancelling the Note is appropriate here, especially given the fact that such cancellation will not result in any windfall or double recovery to Med-Therapy. *Cf. Occidental Life Ins. Co. v. Pat Ryan & Associates, Inc.*, 496 F.2d 1255, 1265-67 (4th Cir.), *cert. denied*, 419 U.S. 1023 (1974). In addition, DCA is enjoined from attempting to collect on the Note.

3. Motion under Fed. R. Civ. P. 59(a) for a New Trial with Respect to Damages on Med-Therapy's Claims for Violations of Rule 10b-5 and for Common Law Fraud

Med-Therapy argues that the "obvious" fact that the jury, in determining the damages that it suffered as a result of DCA's fraud, made no effort to apply the Court's instructions entitles Med-Therapy to a new trial on the issue of damages alone. The fact that the jury awarded Med-Therapy the precise amount, $552,527, that DCA claimed was due under the Note, is very significant to Med-Therapy and it contends that the award is inadequate, against the clear weight of the evidence and in violation of the jury's responsibility to award damages in accordance with the Court's instruction.

Unfortunately, the "obvious facts" enumerated above are not at all "obvious" to the Court. What is obvious to the Court is that Med-Therapy, having opted for a jury trial on a rather complex securities dispute (as it is entitled to do), and having failed to "ring the bell" with the jury, now wishes to have a second go at it. Med-Therapy itself admits that it is wholly within the Court's discretion "to grant a new trial, 'whenever, in its judgment, this action is required to prevent injustice.' This includes ordering a new trial when the jury verdict is contrary to the weight of the evidence." *Slusher v. Arlington County*, 673 F. Supp. 752, 758 (E.D. Va. 1987), quoting *Whalen v. Roanoke County Bd. of Supervisors*, 769 F.2d 221, 226 (4th Cir. 1985).

Generally, a court would not hesitate to grant a new trial if, in its opinion, the award of damages is inadequate

and would result in an injustice. *See Young v. Int'l Paper Co.*, 322 F.2d 820, 822 (4th Cir. 1963). Given the other remedies already provided in the earlier motions, the Court does not find this to be the case here. Further, as the Seventh Circuit has averred, "[t]he assessment of damages is particularly within the province of the jury as the trier of fact, a province in which we do not intrude unless the damages awarded are 'palpably inadequate.' " *Fenolio v. Smith*, 802 F.2d 256, 259 (7th Cir. 1986).

Ms. O'Connell, an expert witness for Med-Therapy, did testify that based on certain adjustments provided to her by her client's accountants, NS&H's stock had a zero value at the time of the transaction. However, the jury is entitled to give whatever weight it deems appropriate to a witness's testimony. *See Gregg v. U.S. Indus., Inc.*, 887 F.2d 1462, 1470 (11th Cir. 1989) ("Even uncontradicted expert opinion testimony is not conclusive, and the jury has every right not to accept it.") The jury could certainly have concluded, consistent with the evidence presented at trial, that the stock of NS&H was not worthless; and/or that Med-Therapy failed to mitigate whatever damages it may have suffered.

Finally, granting a new trial on the issue of damages is particularly inappropriate in a case such as this, where there are indications that the jury's award resulted from some compromise on liability. *See Mekdeci v. Merrell Nat. Laboratories, Div. of Richardson-Merrell Inc.*, 711 F.2d 1510, 1513 (7th Cir. 1983). Therefore, med-therapy's [sic] motion for a new trial on its Rule 10b-5 and fraud damages is denied.

4. Motion in the Alternative, under Fed. R. Civ. P. 59(a), for a New Trial with Respect to DCA's Claims Under the Note

The Court has already rules in favor of Med-Therapy, NS&H and Brian Center on the granting of a declaratory judgment canceling the Note. *See Memorandum Opinion, at 6-8, supra.* It is therefore unnecessary to consider Med-Therapy's motion for a new trial on that issue.

5. Motion under Fed. R. Civ. P. 59(a) for a New Trial with Respect to Med-Therapy's Claim for Violations of the North Carolina Securities Act

Med-Therapy challenges the Court's dismissal of its North Carolina Securities Act claim. The Court ruled, at the end of the plaintiff's case-in-chief, that the state securities claim was to be determined under Tennessee law, the state where both the transaction and the closing occurred. In support of its motion, Med-Therapy points to the Court's earlier ruling that its tort claims would be governed by North Carolina law. Since a claim under the North Carolina Securities Act sounds in tort,[4] Med-Therapy is of the view that the Court erred in not applying the Blue Sky laws of both Tennessee and North Carolina. The Court disagrees with this interpretation. The North Carolina Securities Act expressly applies only where an offer to buy or sell securities originates from that state or is

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[4] *See Simms Invest. Co. v. E.F. Hutton & Co.*, 688 F. Supp. 193, 198 (M.D.N.C. 1988), vacated on other grounds, 699 F. Supp. 543, 545 (M.D.N.C. 1988) (Applying both the Colorado and North Carolina Securities Acts).

directed by the offeror to North Carolina and is received there. *See* N.C.G.S. § 78A-63.

Med-Therapy next contends that there is a nexus between the stock purchase transaction and North Carolina because "the stock was sold to a North Carolina company, causing injury in North Carolina, and the fraudulent misrepresentation was relied upon in North Carolina." Plaintiff's Post-Trial Brief, at 17. Med-Therapy cites no North Carolina or Fourth Circuit decisions for this proposition, and even the Texas court of appeals case that they do cite is inapposite. In *Rio Grande Oil Co. v. State*, 539 S.W.2d 917 (Tex. Civ. App. 1976), the court concluded that the Texas Securities Act would apply *if any act in the selling process* had occurred in Texas (emphasis added). None of the factors purported by Med-Therapy to establish a nexus with the state of North Carolina constitutes "an act in the selling process."

6. Motion under Fed. R. Civ. P. 59(a) for a New Trial with Respect to Med-Therapy's Claim for Violations of the Tennessee Securities Act

Med-Therapy argues that the Court again erred in granting DCA's motion for judgment on the former's Tennessee Securities Act claim, instead of submitting the issue to the jury. DCA had previously moved for summary judgment on Med-Therapy's federal securities claim on the grounds that it was barred by the one-year statute of limitation established by the Supreme Court in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 111 S.Ct. 2773, 115 L.Ed.2d 321 (June 20, 1991). The Court

held, at that time, that there were genuine issues of material fact concerning the statutory defense.

At the end of the plaintiff's proof during the trial, the Court was able to determine, as a matter of law, that Med-Therapy knew or, in the exercise of reasonable diligence, should have become aware of the allegations supporting its Tennessee Securities Act claim.

The Court finds no inherent inconsistency between its earlier ruling and its later conclusion that Med-Therapy's state securities law cause of action was statutorily-barred. Contrary to Med-Therapy's assertion, the evidence presented at the trial was not identical to the record before the Court on DCA's motion for partial summary judgment. The testimony of Med-Therapy's witnesses as to the various dates in which they became aware of the cost report problems, and other details, was not available to the Court when it made the determination on DCA's motion for partial summary judgment.

Accordingly, Med-Therapy's motion for a new trial on its claim under the Tennessee Securities Act is denied.

7. Motion under Fed. R. Civ. P. 59(a) for a New Trial with Respect to Med-Therapy's Claim for Negligent Misrepresentations and Omissions

Med-Therapy also argues that its claims for negligent misrepresentations and omissions should have been submitted to the jury. The Court dismissed these claims on the basis of the parties' Stock Purchase Agreement, section 13.13 of which provides that Med-Therapy relied

solely on the representations set forth in therein, in deciding to purchase the stock of NS&H. Thus, the jury could find DCA liable for misrepresentation only if it found that DCA had breached the representations and warranties in the parties' Agreement. This the jury did not do.

Even a breach of the contract provision would not have given rise to a cause of action for negligent misrepresentation. *North Carolina State Ports Authority v. Lloyd A. Fry Roofing Co.*, 294 N.C. 73, 240 S.E.2d 345, 250 (1978). Finally, given that the jury has already awarded Med-Therapy damages on its Rule 10b-5 and fraud claims, arising from the same omission or misrepresentation, any award here would lead to a double recovery. *See Warfield v. Hicks*, 91 N.C. App. 1, 370 S.E.2d 689, 694, *rev. denied*, 323 N.C. 629, 374 S.E.2d 602 (1988) ("[A]llegations of negligence were mere surplusage, and it thus was error to submit negligence to the jury as an additional basis for relief.")

For these reasons, Med-Therapy's motion for new trial on its negligent misrepresentations and omissions claims is denied.

8. Conditional Motion for an Award of Attorney's Fees

Finally, Med-Therapy, NS&H and Brian Center request an award of attorney's fees in the amount of $333,413, in the event that the Court does not hold the Stock Purchase Agreement to be void. Since the Court has ruled that the Agreement is void, it is unnecessary to rule on this conditional motion.

II. THE MOTIONS OF DIVERSICARE

1. Motion under Fed. R. Civ. P. 50(a) Dismissing Med-Therapy's Rule 10b-5 and Common Law Fraud Claims

DCA argues, in support of the instant motion, that there was "no legally sufficient evidentiary basis for a reasonable jury to have found for" Med-Therapy on its common law and federal securities claims. DCA is of the view that the evidence adduced at trial neither proved that it had the requisite intent to defraud, nor the Med-Therapy suffered actual damages as a result of DCA's fraud. This contention, especially as to the damages issue, is rather incredible and the Court shall not consider it at length.

The damages sought by Med-Therapy were summarized for the jury in Med-Therapy's Trial Exhibit 173, which was admitted into evidence. Several witnesses (including Mr. Davis and Med-Therapy's expert witnesses) testified on this issue, also. As to intent, sufficient evidence was introduced at trial from which a reasonable jury could conclude that DCA acted recklessly, which is the standard under federal securities law. *See e.g., Burlington Indus., Inc. v. Edelman,* 666 F. Supp. 799, 816 (M.D.N.C. 1987), *aff'd,* 1987 WL 91498 (4th Cir. June 22, 1987).

There was also evidence tending to show that several of DCA's employees and/or officers were aware of the significant nature of the adjustments at issue prior to the closing, and yet did not disclose the Medicare reimbursement problems to Med-Therapy. An intent to deceive may

be inferred from the circumstances, the defendant is not required to make an explicit admission to that effect.

However, DCA is quite correct in noting that the federal securities and the common law fraud claims arise from the same allegation of wrongdoing and harm. Permitting Med-Therapy to recover on both would result in a double recovery. *See Wilder v. Hodges*, 80 N.C. App. 333, 342 S.E.2d 57, 334 (1986); *Clifford v. River Bend Plantation, Inc.*, 55 N.C. App. 514, 286 S.E.2d 352, 356 (1982), *aff'd as modified after remand*, 312 N.C. 460, 323 S.E.2d 23 (1984). *See also U.S. Indus., Inc. v. Touche Ross & Co.*, 854 F.2d 1223 (10th Cir. 1988):

> If a federal and a state claim arise from the same operative facts, and seek identical relief, an award of damages under both theories will constitute double recovery. Where a jury award duplicates damages, "the court should, at the conclusion of the trial, either on its own initiative or on motion of a party, reduce the judgment by the amount of [the duplication] and thereby prevent double recovery.

Id. at 1259 (quotations omitted).

Med-Therapy's argument, that the jury's intent should be determinative in this context, proves too much. It is well-established that verdicts are to be aggregated if it is "logical and probable" that the jury intended as much. *See Richmond v. Madison Management Group*, 918 F.2d 438, 460 (4th Cir. 1990). *See also Schutzky Distributors, Inc. v. Kelly*, 643 F. Supp. 57 (N.D. Cal. 1986) (Aggregating awards for violations of Rule 10b-5 and other claims:

> The Court must strive to construe the awards such that they are "logical and probable." It cannot fairly be said that the jury meant to find liability in this case, and yet award what would amount to nominal damages in light of the amounts invested . . . Defendants have never satisfactorily explained the remarkable closeness of the aggregated award to Durham ($48,500) to his out-of-pocket losses ($49,930.98) It is patently obvious that the jury meant to award Durham $48,500, and believed it was being asked to assign portions thereof to each cause of action, as the jury interpreted the evidence. Because the verdicts are "logical and probable" only if they are aggregated, the Court must enter judgment on the aggregated awards.

Id. at 62 (citations omitted)).

As Med-Therapy notes, it does seem that the jury intended to award Med-Therapy a total of $552,527. However, that same jury also awarded DCA the exact amount, on DCA's counterclaim under the Note. This does not appear to be a mere coincidence. The jury in the instant action clearly intended that the parties should come out in "a wash" (aside from the $1,000 punitive damages award). The circumstances in *Schutzky* are wholly different from those in the present litigation.

Accordingly, the Court holds, as a matter of law, that the damages awarded Med-Therapy are subsumed by the larger award for federal securities fraud. However, DCA's motion to dismiss the Rule 10b-5 and fraud claims is denied.

2. Motion under Fed. R. Civ. P. 50(a) Awarding DCA Interest on the Principal Amount due under the Note

The Court has previously determined that the Note is null and void, and that DCA has no rights thereunder. *See* Memorandum Opinion, at 6-8, *supra*. Thus, the question of interest due under the Note has been rendered moot.

3. Motion for an Award of Attorney's Fees

For the same reason noted above, that is, the Court's determination that DCA's fraud vitiated the Agreement between the parties, DCA's request for an award of attorney's fees is also denied.

CONCLUSION:

Med-Therapy's, NS&H's and/or Brian Center's motion for: (i) a declaratory judgment requiring indemnification from DCA is GRANTED; (ii) a declaratory judgment cancelling the Note is GRANTED; and (iii) a new trial on various claims is DENIED. DCA's motion: (ii) to dismiss as a matter of law, Med-Therapy's fraud and federal securities claims, is DENIED; (v) for judgment on in its counterclaim under the Note, for principal and interest in an amount of $776,507, is DENIED; and (iii) for attorneys' fees and costs is DENIED. Finally, Med-Therapy is entitled to compensatory damages for a total of $300,000, and to punitive damages in the amount of $1,000.

Let the Clerk send a copy of this Memorandum Opinion and the accompanying Order to all counsel of record.

11/25/92
DATE

/s/ Richard L. Williams
SENIOR UNITED STATES
DISTRICT JUDGE

UNITED STATES DISTRICT COURT

WESTERN DISTRICT OF NORTH CAROLINA

MED-THERAPY REHABILITATION SERVICES, INC.,

Plaintiff

V.

DIVERSICARE CORPORATION OF AMERICA, Defendant, Counter-Plaintiff and Third-Party Plaintiff,

v.

NATIONAL SPEECH AND HEARING SERVICES, INC. and BRIAN CENTERS MANAGEMENT, INC., Third-Party Defendants

JUDGMENT IN A CIVIL CASE

(Filed Nov. 30, 1992)

CASE NUMBER: ST-C-91-28-P

[ ] **Jury Verdict.** This action came before the Court for a trial by jury. The issues have been tried and the jury has rendered its verdict.

[ ] **Decision by Court.** This action came to trial or hearing before the Court. The issues have been tried or heard and a decision has been rendered.

IT IS ORDERED AND ADJUDGED that final judgment is hereby entered pursuant to the Final Order of the Court filed on November 30, 1992.

November 30, 1992
Date

THOMAS J. MCGRAW
Clerk

/s/ Carolyn B. Bouchard
(By) Deputy Clerk

IN THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF NORTH CAROLINA

Statesville Division

MED-THERAPY REHABILITATION SERVICES, INC., Plaintiff,	**CIVIL ACTION NO. ST-C-91-28-P**
v.	
DIVERSICARE CORPORATION OF AMERICA, Defendant, Counter-Plaintiff and Third-Party Plaintiff,	**(Filed Nov. 30, 1992)**
v.	
NATIONAL SPEECH AND HEARING SERVICES, INC., AND BRIAN CENTERS MANAGEMENT, INC. Third-Party Defendants.	

FINAL ORDER

This matter is before the Court on the respective post-trial motions of the parties. The plaintiff, Med-Therapy Rehabilitation Services, Inc. ("Med-Therapy"), and the third-party defendants, National Speech and Hearing Services, Inc. (NS&H") and Brian Center Management Corporation ("Brian Center"), have moved (individually, by Med-Therapy alone, and collectively, respectively) for declaratory judgments: (i) requiring indemnification from

DCA on any claims against Med-Therapy relating to certain pre-acquisition cost reports filed by NS&H; and (ii) cancelling the promissory note (the "Note") executed by the parties pursuant to the stock purchase agreement, ad declaring that DCA has no rights thereunder.

Med-Therapy has also moved for a new trial with respect to: (i) its damages pursuant to its Rule 10b-5 and common law fraud claims; (ii) DCA's counterclaim, pursuant to the Note (in the event that the Court does not provide the prior requested declaratory relief); and (iii) Med-Therapy's claims under the North Carolina and Tennessee Securities Acts, and also its claims for negligent misrepresentations and omissions. Finally, Med-Therapy has also field a conditional request for attorneys' fees.

The defendant, counter-plaintiff and third-party plaintiff, Diversicare Corporation of America ("DCA"), in turn, has moved for entry of judgment as a matter of law on all four claims that Med-Therapy pursued against DCA at the trial. DCA has also filed a motion for entry of judgment as a matter of law on its third-party and counterclaim under the Note (for principal and interest in the amount of $776,507.00). In addition, DCA requests attorneys' fees and costs in the amount of $322,022.09.

For the reasons presented in the Memorandum Opinion: (i) Med-Therapy's motion for a declaratory judgment requiring indemnification from DCA is GRANTED; (ii) Med-Therapy's, NS&H's and Brian Center's motion for a declaratory judgment cancelling the Note IS GRANTED; (iii) Med-Therapy's motions for a new trial on the various causes of action is DENIED; (iv) DCA's motion to dismiss Med-Therapy's fraud and Rule 10b-5 claims as a matter of

law is DENIED, in part; (v) DCA's motion for entry of judgment as a matter of law on its claim under the Note is DENIED; (vi) DCA's motion for attorneys' fees and costs is DENIED.

Judgment is entered in favor of Med-Therapy in the total amount of $301,000.00, plus interest at the legal rate, from October 19, 1992.

It is so ORDERED.

Let the Clerk send a copy of this Order to all counsel of record.

11/25/92
DATE

/s/ Richard L. Williams
SENIOR UNITED STATES
DISTRICT JUDGE

UNITED STATES COURT OF APPEALS

FOR THE FOURTH CIRCUIT

FILED
March 4, 1994

No. 93-1176
CA-91-28

MED-THERAPY REHABILITATION SERVICES, INCORPORATED

Plaintiff-Appellee

v.

DIVERSICARE CORPORATION OF AMERICA

Defendant & Third Party Plaintiff-Appellant

v.

N S & H, INCORPORATED; BRIAN CENTER MANAGEMENT CORPORATION

Third Party Defendants-Appellees

No. 93-1210
CA-91-28

MED-THERAPY REHABILITATION SERVICES, INCORPORATED

Plaintiff-Appellant

v.

DIVERSICARE CORPORATION OF AMERICA

Defendant & Third Party Plaintiff-Appellee

v.

N S & H, INCORPORATED; BRIAN CENTER MANAGEMENT CORPORATION

Third Party Defendants

ORDER

Appellant has filed a petition for rehearing.

The Court denies the petition for rehearing.

For the Court,

/s/ Bert M. Montague
CLERK

15 U.S.C. § 78cc. Validity of contracts

(a) Waiver provisions. Any condition, stipulation, or provision binding any person to waive compliance with any provision of this title or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void.

(b) Contract provisions in violation of title. Every contract made in violation of any provisions of this title or of any rule or regulation thereunder, and every contract (including any contract for listing a security on an exchange) heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this title or any rule or regulation thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule or regulation: Provided, (A) That no contract shall be void by reason of this subsection because of any violation of any rule or regulation prescribed pursuant to paragraph (3) of subsection (c) of section 15 of this title [15 USCS § 78o(c)(3)], and (B) that no contract shall be deemed to be void by reason of this subsection in any action maintained in reliance upon this subsection, by any person to or from whom any broker or dealer sells, or from or for whom any broker or dealer purchases, a security in violation of any rule or regulation prescribed pursuant to paragraph (1) or (2) of subsection (c) of section 15 of this

title [15 USCS § 78 o(c)(1) or (2)], unless such action is brought within one year after the discovery that such sale or purchase involves such violation and within three years after such violation. The Commission may, in a rule or regulation prescribed pursuant to such paragraph (2) of such section 15(c) [15 USCS § 78o(c)(2)], designate such rule or regulation, or portion thereof, as a rule or regulation, or portion thereof, a contract in violation of which shall not be void by reason of this subsection.

(c) Validity of loans, extensions of credit, and creation of liens, actual knowledge of violation. Nothing in this title shall be construed (1) to affect the validity of any loan or extension of credit (or any extension or renewal thereof) made or of any lien created prior or subsequent to the enactment of this title enacted June 6, 1934, unless at the time of the making of such loan or extension of credit (or extension or renewal thereof) or the creating of such lien, the person making such loan or extension of credit (or extension or renewal thereof) or acquiring such lien shall have actual knowledge of facts by reason of which the making of such loan or extension of credit (or extension or renewal thereof) or the acquisition of such lien is a violation of the provisions of this title or any rule or regulation thereunder, or (2) to afford a defense to the collection of any debt or obligation or the enforcement of any lien by any person who shall have acquired such debt, obligation, or lien in good faith for value and without actual knowledge of the violation of any provision of this title or any rule or regulation thereunder affecting the legality of such debt, obligation, or lien.

(2)

Supreme Court, U.S
FILED
JUL 1 1994
OFFICE OF THE CLERK

No. 93-1949

In The

Supreme Court of the United States

October Term, 1993

MED-THERAPY REHABILITATION SERVICES, INC., NS&H, INC. and BRIAN CENTER MANAGEMENT CORPORATION,

Petitioners,

vs.

DIVERSICARE CORPORATION OF AMERICA,

Respondent.

On Petition For Writ of Certiorari To The United States Court of Appeals For the Fourth Circuit

RESPONDENT'S BRIEF IN OPPOSITION

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STATEMENT OF THE CASE

Med-Therapy Rehabilitation Services, Inc. ("Med-Therapy") bought the stock of National Speech and Hearing Services, Inc. ("National") from Diversicare Corporation of America ("Diversicare")[1] pursuant to a Stock Purchase Agreement. The purchase price for National's stock was (1) a $750,000 cash payment from Med-Therapy to Diversicare and (2) a $700,000 promissory note (the "Note") to Diversicare from National that was guaranteed by Med-Therapy and its parent corporation.

Med-Therapy filed suit in April 1991. Med-Therapy claimed that Diversicare breached the Stock Purchase Agreement; committed common-law fraud; and violated state and federal securities laws. Diversicare filed a counterclaim and third-party complaint for the amount due under the Note that was part of the Stock Purchase Agreement.

Before trial, Med-Therapy opted against rescission. Med-Therapy chose instead to affirm the Stock Purchase Agreement and seek damages for breach of contract and for fraud. Med-Therapy's counsel began the trial by confirming Med-Therapy's election of remedies:

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[1] Diversicare Corporation of America has recently changed its name to DCAmerica Inc. Counselcare Ltd., a Delaware corporation, is the parent of DCAmerica Inc., and American HomePatient, Inc., a Delaware corporation, is a subsidiary of DCAmerica Inc.

The Court: ...And incidentally, you didn't sue for rescission here, did you?

Counsel: We have not. We are not specifically asking for rescission.

The Court: But you could have.

Counsel: We could have.

(Tr. Vol. II, 4-5).

The jury found against Med-Therapy on the breach-of-contract claims and awarded Diversicare $552,527, the exact amount Diversicare claimed was due under the Note. The jury found for Med-Therapy on its federal securities and common-law fraud claims and awarded damages totaling $553,527. The jury's verdict netted Med-Therapy a $1,000 victory.[2]

After hearing the jury's verdict, Med-Therapy *for the first time* invoked Section 29(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78cc(b)) and asked in post-trial motions that the district court ignore the jury's verdict and void the contract that Med-Therapy had just sued to enforce.

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[2] Med-Therapy wrongly states that Diversicare misrepresented in the Stock Purchase Agreement that National's cost reports complied with applicable Medicare regulations (Petition at 4). The jury specifically found on a special verdict form that Diversicare did not breach any representation or warranty in the Agreement.

The district court granted Med-Therapy's post-trial motion for rescission. The Court of Appeals reversed that decision.

REASONS FOR DENYING THE PETITION

SUMMARY OF ARGUMENT

MED-THERAPY'S DECISION TO AFFIRM THE PARTIES' CONTRACT AND SUE FOR DAMAGES PREVENTED MED-THERAPY FROM SEEKING POST-TRIAL RESCISSION.

Med-Therapy's petition ignores the critical fact that Med-Therapy opted before trial to enforce rather than to rescind the Stock Purchase Agreement between the parties. Med-Therapy sought rescission under Section 29(b) of the Securities Exchange Act of 1934 only after seeking breach-of-contract and fraud damages from the jury.

Med-Therapy fails to address the effect its election of remedies had on any right to rescissionary relief under Section 29(b). Instead, Med-Therapy implies that the Court of Appeals' ruling precluded Med-Therapy from choosing rescission under Section 29(b) because Diversicare had performed under the Stock Purchase Agreement (Petition at i, 6-7).

The question Med-Therapy poses for review by this Court is not even an issue in this case. The district court gave Med-Therapy a choice of remedies at trial. This case is about the consequences once Med-Therapy made its choice.

The Court of Appeals held that a plaintiff may not both affirm and rescind a contract for the purchase of securities (App. 8-11). After asking that the jury enforce the Stock Purchase Agreement and award Med-Therapy damages for breach of that contract and for fraud, Med-Therapy had no right under Section 29(b) to post-trial rescissionary relief inconsistent with the jury's verdict (*Id.*). The Court of Appeals held that Med-Therapy and the district court had to honor the jury's verdict (*Id.*).

No authority suggests this ruling was incorrect. It is consistent with prior decisions of this Court and with the holdings of other courts that require a securities fraud plaintiff to choose between available remedies. It recognizes that trial courts do not have "broad...powers" to change jury verdicts (Petition at 15). This Court should deny Med-Therapy's petition for a writ of certiorari.

A. Section 29(b) Does Not Relieve A Plaintiff From The Consequences Of Its Decision To Affirm A Contract.

Section 29(b) renders a contract "merely voidable at the option of the innocent party." *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 388 (1970). *See also Transamerica Mortgage Advisers, Inc. v. Lewis*, 444 U.S. 11, 18-19 (1979) (*Mills* recognized that Section 29(b) "confers a "right to rescind" a contract void under the criteria of the statute.").[3]

A securities fraud plaintiff must choose between rescission and out-of-pocket damages. *See Randall v. LoftsGaarden*, 478 U.S. 647, 662 (1986); *Occidental Life Insurance v. Ryan & Assoc. Inc.*, 496 F.2d at 1267

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[3] Lower courts also recognize that Section 29(b) merely gives a plaintiff the option of affirming or rescinding a contract. *E.g.*, *Occidental Life Ins. Co. v. Ryan & Assoc., Inc.*, 496 F.2d 1255, 1266-67 (4th Cir.), *cert. denied*, 419 U.S. 1023 (1974) (Section 29(b) renders a contract not void but merely voidable at the option of the innocent party); *Moody v. Bache & Co., Inc.*, 570 F.2d 523, 527 n. 6 (5th Cir. 1978) ("highly questionable" after *Mills* whether plaintiff may invoke Section 29(b) where plaintiff has sought "a remedy comparable to money damages"); *Goldman v. Bank of Commonwealth*, 467 F.2d 439, 446 (6th Cir. 1972) ("[C]ontracts subject to the Draconian language of [Section 29(b)] are...not truly "void" but more properly are "voidable" since the law in effect gives an innocent party the right to affirm or rescind.").

(counterclaimant alleging securities fraud "had the option to affirm the contract and sue for damages, or it could elect to rescind"). *Cf. Mills,* 396 U.S. at 388 ("The interests of the victim are sufficiently protected by giving him the right to rescind."). This Court wrote in *LoftsGaarden* that a Section 10(b) plaintiff, in some circumstances, may "choose between 'undoing the bargain (when events since the transaction have not made rescission impossible) or holding the defendant to the bargain by requiring him to pay [out-of-pocket] damages.'" *LoftsGaarden*, 478 U.S. at 662.

Consistent with this Court's precedent, the Court of Appeals held that Med-Therapy had to choose between remedies at trial (App. at 8-10). Med-Therapy could seek to rescind the parties' Stock Purchase Agreement, or Med-Therapy could sue to enforce that Agreement and seek damages for breach of contract and for fraud. Given this Court's prior rulings, the Court of Appeals correctly ruled that Med-Therapy could not do both (*Id.*).

Once Med-Therapy opted against rescission of the Stock Purchase Agreement, it was no longer "an unwilling innocent party" against whom the Agreement could not be enforced. *Mills*, 396 U.S. at 387. Med-Therapy willingly chose to enforce the Agreement. Med-Therapy regretted its choice after the jury returned the verdict, but Section 29(b)

did not enable Med-Therapy to elect a different, inconsistent remedy from the judge in a post-trial motion.[4]

B. This Court's Decisions Regarding The Province Of The Jury Support The Court Of Appeals' Ruling.

Med-Therapy complains that the Court of Appeals' ruling unduly limits the flexibility of trial judges when "fashioning relief" (Petition at 15, n.9). Every case Med-Therapy cites for its flexibility argument involved a bench trial. Med-Therapy's case law is irrelevant because Med-

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[4] Although the Court of Appeals focused only on the election-of-remedies principle, a waiver analysis reaches the same result. Courts have treated Section 29(b) as creating a separate implied cause of action for rescission, subject to all traditionally available equitable defenses. *E.g.*, *Regional Properties, Inc. v. Financial and Real Estate Consulting Co.*, 678 F.2d 552, 562 (5th Cir. 1982). *Cf. Transamerica Mortgage Advisers, Inc. v. Lewis*, 444 U.S. at 19 (holding that a very similar provision, § 215 of the Investment Advisors Act of 1940, creates an implied private cause of action for rescission). Waiver and estoppel are two such equitable defenses. *Regional Properties*, 678 F.2d at 562; Gruenbaum and Steinberg, Section 29(b) of the Securities Exchange Act of 1934: A Viable Remedy Awakened," 48 Geo. Wash. L. Rev. 1, 36-37 (1979). When Med-Therapy chose to affirm the Stock Purchase Agreement and seek out-of-pocket and breach-of-contract damages from the jury, it waived any right to post-trial rescission under Section 29(b).

Therapy demanded and received a trial by jury in this case. District courts do not have broad power to change jury verdicts. The Court of Appeals properly held:

> Although the judge may have broad legal and equitable powers to order the relief necessary to effectuate the purposes of the securities laws under *Mills v. Electric Auto-Lite*, those powers are circumscribed when the judge is fashioning that relief subsequent to a jury verdict. The facts on which the judge bases his equitable or declaratory relief must not contravene the facts as found by the jury. *In re Lewis*, 845 F.2d 624, 629 (6th Cir. 1988) ("[a]ccording to the progeny of *Beacon Theatres, Inc. v. Westover*, 359 U.S. 500 (1959), the legal claim...must be tried first before a jury and the equitable claim resolved subsequently *in light* of the jury's determination of the legal claim." *Id.*)

(App. 11) (footnote omitted).

The district court's post-trial order granted equitable relief inconsistent with the jury's legal relief. Med-Therapy blithely claims that voiding Diversicare's rights under the Note was "fully warranted under the traditional measure of damages for Rule 10b-5 claims" (Petition at 17). Med-Therapy forgets that, at Med-Therapy's election, a properly instructed jury determined the proper amount of damages.

The district court's decision increased the jury's net $1,000 verdict for Med-Therapy to a net $301,000 verdict.

The district court erred, and the Court of Appeals corrected that error. The jury's verdict was the end, not the beginning, of Med-Therapy's quest for a big judgment. *Cf. Dimick v. Schiedt*, 293 U.S. 474 (1935) (additur violates the Seventh Amendment).[5]

C. Med-Therapy Has Not Cited One Case Holding That Section 29(b) Allows A Party To Seek Breach-Of-Contract And Fraud Damages From A Jury And Then, If Disappointed With The Verdict, Seek Rescission From The Judge.

Med-Therapy's petition turns on the existence of a conflict among the Courts of Appeals requiring action by this Court. Med-Therapy's petition contains only one paragraph discussing the decisions Med-Therapy claims create this conflict (Petition at 11-12). None of these cases even suggests that a party may affirm an agreement for the purchase of securities, ask a jury to award out-of-pocket damages for fraud and breach of that agreement, and then

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[5] Even the district court acknowledged: "What is obvious to the Court is that Med-Therapy, having opted for a jury trial on a rather complex securities dispute (as it is entitled to do), and having failed to 'ring the bell' with the jury, now wishes to have a second go at it" (App. 7-8).

circumvent the jury's verdict by seeking post-trial rescission under Section 29(b).[6]

No authority holds that Section 29(b) frees a securities plaintiff from a jury's unfavorable verdict. Med-Therapy lost any right to rescission when it asked the jury to enforce the Stock Purchase Agreement and award it damages for breach of contract and for fraud. Because Med-Therapy asked the jury to enforce the Agreement, Diversicare could ask for the same. *See Miller v. Premier Corp.*, 608 F.2d 973, 983 (4th Cir. 1979) ("[A] party to [a] contract who sues to recover damages for fraud in the

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[6] The parties alleging securities fraud in Med-Therapy's cases, unlike Med-Therapy, sought rescissionary relief at trial. *See Regional Properties, Inc. v. Financial and Real Estate Consulting Co.*, 678 F.2d 552, 554-56 (5th Cir. 1982); *Sundstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033, 1036 (7th Cir.), *cert. denied*, 434 U.S. 875 (1977); *Eastside Church of Christ v. National Plan, Inc.*, 391 F.2d 357 (5th Cir.), *cert. denied*, 393 U.S. 913 (1968); *Myzel v. Fields*, 386 F.2d 718, 740-41 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968); *Errion v. Connell*, 236 F.2d 447, 449 (9th Cir. 1956); *Prudential Bache Secur., Inc. v. Cullather*, 678 F. Supp. 601, 603 n.1 (E.D. Va. 1987). Only one of Med-Therapy's cases, *Myzel v. Fields*, was tried to a jury, and the court in that case made no attempt to alter the jury's verdict after it had been rendered. Med-Therapy's cases therefore do not even address the issue in this case.

inducement rather than seeking rescission has thereby affirmed the contract and consequently assumed liability for its breach.").[7] Med-Therapy has not cited one case in conflict with this analysis.

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[7] Even Med-Therapy's authorities agree. "Under Section 29(b), the violating party cannot enforce the contract or sue for damages *when the non-offending party elects to terminate the contract.*" Gruenbaum and Steinberg at 17 (quoted in Petition at 13-14) (emphasis added).

CONCLUSION

Med-Therapy elected to affirm the Stock Purchase Agreement. Med-Therapy demanded a jury. The jury returned a verdict consistent with the evidence after receiving proper instructions. The Court of Appeals held that Section 29(b) did not allow the district court to overhaul that verdict and grant Med-Therapy relief inconsistent with Med-Therapy's choice of remedies and of fact finder at trial. Med-Therapy has not cited one case that conflicts with that unremarkable ruling. This Court should deny the petition.

Respectfully submitted,

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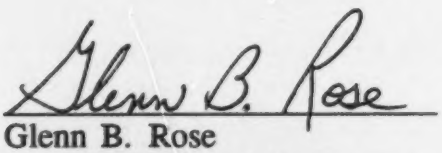
By: 
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